

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY**

FOR

MANAGER DEVELOPMENT PROGRAM (MDP) MANAGER GRADUATION

February 14, 2005

This Policy is effective immediately upon adoption and supersedes all previous manager development program (MDP) manager graduation policies.

I. PURPOSE

This document sets forth the investment policy ("the Policy") for Global Equity with respect to the graduation of firms from CalPERS' Manager Development Program (MDP) into a direct contractual relationship with CalPERS for the management of CalPERS' assets.

II. INTRODUCTION

Under its MDP, CalPERS provides venture capital and investment assets to small and emerging investment management firms in exchange for an equity stake in those firms. The returns from the venture capital investments augment the returns earned on the assets managed. The MDP is structured through limited liability company agreements for both venture and investment assets.

This policy permits CalPERS to contract directly with MDP firms that meet specified criteria. The Program is managed to accomplish the following:

- A.** Diversify the system's overall Equity Program by complementing the Passive Domestic Equity Program;
- B.** Enhance the expected return of the System's investment program;
- C.** Hedge against active member (pre-retirement) liabilities; and
- D.** Consider solely the interests of the System's participants and their beneficiaries in accordance with California State Law.

III. RESPONSIBILITIES AND DELEGATIONS

- A.** The **System's Investment Committee** ("the Investment Committee") is responsible for approving and amending the Policy. The Investment Committee delegates the responsibility for administering the MDP and the

externally managed portion of the System to the Staff through the Delegations of Authority (Delegation Nos. 89-13 and 95-50).

B. The System's Investment Staff ("the Staff") duties include, but are not limited to, the following:

1. Developing and recommending the Policy to the Investment Committee.
2. Developing and maintaining a procedures manual, subject to periodic reviews and updates, outlining Staff operational procedures to be used in implementing this Policy;
3. Implementing and adhering to the Policy;
4. Evaluating MDP firms for possible graduation under this policy;
5. Recommending action with respect to the MDP firms retained to implement the Program. The Staff shall make recommendations in accordance with the Manager Monitoring - Externally Managed Policy, regarding changes in the manager's contractual guidelines, or regarding any other aspect the Staff considers pertinent.
6. Reporting to the Investment Committee, as needed, about the performance of the Program. The Staff shall report concerns, problems, material changes, and all violations of Guidelines and Policies immediately, and in writing, to the Investment Committee. Reports made by the Staff to the Investment Committee shall include explanations of the violations and appropriate recommendations for corrective action.

C. MDP Partners shall be responsible for all aspects of compliance with their investment charter that shall include the following duties:

1. Sourcing potential MDP firms for investment and providing due diligence evaluation for consideration by CalPERS;
2. Recommending the allocation of monies to the MDP firms that have been selected from that portion of assets allocated for investment under their charter. However, they are not responsible for determining any MDP firm's graduation to mainstream status for CalPERS;
3. Monitoring the MDP firms and providing input and communication to the CalPERS Staff regarding the investment and business performance of these firms;

4. Providing business management and administrative advice and support in an effort to develop the MDP firms in which investments have been made; and,
 5. Cooperating fully with the CalPERS Staff, custodian and General Pension Consultant concerning requests for information.
- D. MDP firms** are responsible for all aspects of portfolio management as set forth in their respective contracts with the System and shall fulfill the following duties:
1. Communicating with the MDP Partner and Staff as needed regarding investment strategy and investment results. The MDP firms are expected to monitor, analyze, and evaluate performance relative to the agreed upon benchmark; and
 2. Cooperating fully with the Staff, the System's custodian and the General Pension Consultant concerning requests for information.
- E.** The **General Pension Consultant** shall be responsible for independently monitoring and evaluating the MDP firms and for reporting recommendations, if any, directly to the Investment Committee on a quarterly basis, in accordance with the terms of its contract.

IV. MANAGER EVALUATION

CalPERS' MDP permits investment in small and emerging investment management firms with less than \$2 billion under management, whose primary investment focus is in public equity and fixed income markets, and whose primary market focus is institutional clients. The CalPERS Investment Committee has set a fixed amount of assets for the MDP, which is appropriate given the fees associated with the program. Firms in the MDP may be graduated into a direct contract with CalPERS for the management of System assets if all of the following conditions are met, and contingent upon successful negotiation of fees:

- A.** The MDP firm has been successful with respect to any of the following: attracting significant assets from investors other than CalPERS; demonstrating profitability without additional assets from CalPERS; or attracting other corporate or public pension fund or endowment/foundation clients who have completed successful due diligence on the manager, regardless of the size of the assets awarded.
- B.** The MDP firm has competitive risk-adjusted performance;

- C.** Additional assets allocated to the MDP firm's investment approach and style will enhance CalPERS' overall manager structure in the relevant asset class;
- D.** During the entire MDP investment period, the MDP partner has the right of first refusal for any additional assets funded to MDP firms, provided the additional assets would not constitute a breach of the diversification limit in the MDP Partner's investment charter;
- E.** The Investment Committee approves an exemption from competitive bidding process resolution for the firm based on a best business practice decision (CalPERS Board of Administration Resolution No. 92-04B-2).

The System's Investment Staff will evaluate and recommend MDP firms for graduation based on the above criteria. The General Pension Consultant will provide an opinion letter.

V. GLOSSARY OF TERMS

The Equities Glossary of Terms is referenced in the CalPERS Master Glossary of Terms.